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SUBJECT: BARBADOS 2005 ECONOMIC REVIEW

REF: A. BRIDGETOWN 386
[1](#)B. BRIDGETOWN 178
[1](#)C. 05 BRIDGETOWN 1217

[1](#)1. Summary: The Barbados economy performed well in 2005. GDP growth, inflation, and unemployment registered 4.1, 5.1, and 8.5 percent, respectively. Construction drove growth, making up for a drop in tourism. The fiscal deficit (2.9 percent of GDP) and the national debt (88 percent of GDP) have both been increasing due to government spending on Cricket World Cup 2007 preparations. High world energy prices helped push up inflation, while the buzzing economy drove unemployment to record lows. Barbados struggles with a structural trade deficit but has kept the outflow of foreign exchange at a reasonable level. Prime Minister (and Finance Minister) Owen Arthur's economic policies of encouraging private investment and promoting regional economic integration appear to be working well. Most commentators expect economic growth of around 4.0 percent for 2006. End Summary.

Overview

[1](#)2. Barbados is the fourth wealthiest independent country per capita in the Western Hemisphere (behind the U.S., Canada, and the Bahamas). Barbados' per capita annual income is around US\$12,000. The country benefits from a strong education system, stable currency, healthy democracy, and solid rule of law. For centuries a sugar monoculture, the Barbadian economy now relies on tourism and financial services. The global slowdown in tourism after the September 11 attacks hurt the island's economy, but it quickly recovered and has grown at a moderate pace for the past three years. GDP growth, inflation, and unemployment registered 4.1, 5.1, and 8.5 percent, respectively, in 2005. High world energy prices helped push up inflation, while the buzzing economy drove unemployment to record lows. The government oversaw an increasing fiscal deficit (2.9 percent of GDP) and a high level of debt (81.3 percent of GDP). Preparations to host several games and the final of the Cricket World Cup in 2007 have given the economy a boost.

Construction-led Growth

[1](#)3. Construction drove growth in 2005. Preparations for the 2007 Cricket World Cup, as well as a healthy expansion in high-end residential and tourism development, caused construction activity to rise by a whopping 17.6 percent. The rapid increase in demand for construction workers outstripped the locally available supply, leading companies to import labor. In one well-publicized case, the company

renovating the cricket stadium brought in workers from India and was paying them well below the prevailing wage (Ref A). After a public outcry, the government ended up deporting the Indians but letting back in a different group of their countrymen. According to Chris DeCaires, Chairman of World Cup Barbados, the construction company was able to bring in new workers after promising the government that the Indian workers would be paid better wages.

Decline in Tourism

¶4. After two years of exceptional growth (averaging 8.1 percent) the number of tourists visiting Barbados declined in ¶2005. The number of tourists staying overnight in Barbados dropped by 1.1 percent, while the number of cruise ship tourists plummeted by 22.7 percent. Rising fuel prices forced many cruise lines to compress ship itineraries to save money on fuel, leaving farflung Barbados off the schedule. The newly renovated Hilton Hotel (opened in May 2005) enjoyed immediate success and hosted many high profile events, including the CARICOM-Cuba Summit in December 2005. The tourism-friendly west and south coasts of the island are thickly built up, leaving the country with little available land for coastal tourism development. Future growth in this sector may depend on extracting more money per tourist rather than increasing the number of tourists.

Possible Pitfalls

¶5. The IMF and Standard and Poor's have both warned Barbados

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to keep a close eye on its trade deficit, fiscal deficit, and debt load, all of which have been increasing. These factors have led to a decline in foreign exchange reserves that could, if unchecked, threaten the stability of the economy and the viability of the longstanding currency peg of two Barbados dollars to one U.S. dollar. The country has thus far been able to balance these possibly destabilizing influences. The Central Bank steadily raised interest rates throughout the year and the Ministry of Finance put an additional tax on imports in September 2005. These measures have helped dampen imports and reduce the foreign exchange outflow. The government will likely increase its fiscal deficit through 2006 and 2007 to pay for hosting Cricket World Cup. The country has invested extensively, both in the public and private sectors to prepare for this sporting event, and the government is gambling that these investments will continue to bear fruit long after the games are over.

Comment

¶6. Overall, Barbados is a stable, growing economy in a vibrant, free democracy. The country is trying to make the leap from a high-income developing nation to the ranks of the developed world, but tourism alone will not likely get them there. Near-shore call centers and business services coupled with niche exports such as crafts and food products, along with a small but surviving assembly sector, could help the country earn more foreign exchange and promote a healthier balance of payments. Successive generations of political leaders have kept the country free from excessive debt, high inflation, currency instability, and runaway unemployment. Prime Minister (and Finance Minister) Arthur appears to be following the same wise path by promoting private investment and encouraging regional economic integration. In the years to come Barbados should enjoy similar economic growth to that of 2005.

KRAMER